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TAGS: EFIN ECON EINV WTRO PGOV CH
SUBJECT: CBRC ASSISTANT MINISTER'S AND BANKERS' VIEWS ON
DRAFT ADMINISTRATIVE RULES FOR FOREIGN BANKS

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SUMMARY AND COMMENT

¶1. (SBU) SUMMARY: On August 25, FinAtt and Econoff met China Banking Regulatory Commission (CBRC) Assistant Chairman Wang Zhaoxing to discuss draft administrative rules on foreign banks, which would implement China's WTO accession obligations in this sector. While Wang noted the regulations are intended to provide national treatment between Chinese and foreign banks, he acknowledged some of the concerns raised by foreign banks and committed to revise the regulations to address them.

¶2. (SBU) Separately, FinAtt spoke to two foreign banking executives who had reviewed the regulations. While they had a few concerns, banking contacts were glad the regulations had been issued early and that Chinese regulators are now seeking comments. While the regulations give foreign banks a strong incentive to establish local subsidiaries with relatively high capitalization requirements in order to conduct RMB denominated services, this was not viewed as a significant barrier to entry or expansion for banks intending to establish large branch networks. END SUMMARY

¶3. (SBU) COMMENT: The regulations, however, impede market access for smaller banks or those seeking to establish smaller branch networks, and as such, favor large incumbents. In addition, requiring foreign banks to establish subsidiaries and then regulating activities based on capitalization, while consistent with national treatment obligations, favors domestic banks which have almost all their regulatory capital in China. Even if industry concerns are addressed, contacts expect the time consuming and opaque regulatory process to slow organic expansion of foreign-controlled banks for the foreseeable future. END SUMMARY AND COMMENT

DRAFT REGULATIONS

¶4. (SBU) In an August 25 meeting between FinAtt and CBRC Assistant Chairman Wang Zhaoxing, FinAtt and Econoff expressed the United States Government's interest in and willingness to review and comment on draft administrative rules. Wang confirmed that the CBRC intends to complete the regulations in September, which will then allow the State Council to enact them by November 1. Wang, who had also presided over a meeting between CBRC and foreign banks this week, said there would be an opportunity to review the regulations.

¶5. (SBU) Wang asserted consistency between the regulations and China's WTO commitments, which offer foreign banks the right to choose their legal form of establishment. The draft regulations, however, give banks a strong incentive to incorporate as subsidiaries. Wang noted that the draft regulations had been heavily influenced by U.S. regulations, which require foreign banks to incorporate to qualify for FDIC insurance. FinAtt pointed out that the USG does not require incorporation if the bank does not wish to take insured deposits, and seeks, as one example, to establish a credit card business. Wang responded that the CBRC believes credit cards would be "closely related" to retail deposits in China.

¶6. (SBU) FinAtt raised the concern that banks which had already been approved as qualified foreign institutional investors (QFII) and qualified domestic institutional investors (QDII) might no longer meet requirements that they manage a certain amount of assets (USD 10 billion for QFIIs) if they incorporated as subsidiaries. While Wang stated that one aim of the regulations is to provide national treatment between foreign and domestic banks, he acknowledged this potential problem and said his agency would be willing to review the issue.

¶7. (SBU) On the question of whether banks that switch to subsidiaries would be required to "reset the clock" in establishing a three-year foreign exchange business track

record with two years of profitability in order to conduct RMB denominated activities, Wang noted that the "CBRC will give positive consideration to the full continuity of the business." (Comment: This suggests that although the CBRC would not tie itself down on the issue, it intends to give already established banks credit for time spent offering foreign exchange related services as branches. End Comment.)

¶8. (SBU) In response to FinAtt's question on whether limits on lending o a single borrower applied to asubsidiary's capital rather than the consolidated capital of a branch's parent would reduce the amount of lending banks could make to corporate customers, Wang offered that the CBRC is willing to make "special arrangements" for large commercial banks such as Citigroup and HSBC. CBRC would allow them to create "booking branches," for booking large exposures against the consolidated capital of the parent.

FDI LIMITATIONS

¶9. (SBU) Regarding FDI limits for domestic banks, Wang reiterated that the CBRC welcomes foreign strategic investors. Wang added that while the CBRC plans to develop new regulations for M&A, he does not foresee significant changes to the current limitations on foreign ownership of Chinese banks. On Citigroup's bid for Guangdong Development Bank (GDB), Wang said that a final decision would occur "soon" because GDB desperately needs financial restructuring. FinAtt noted that the USG is watching this deal with great interest and that Treasury Secretary Paulson

is also coming to China "soon."

PRIVATE SECTOR REACTION TO DRAFT REGULATIONS

¶10. (SBU) FinAtt spoke separately to two foreign banking executives who had reviewed the draft regulations. They said that while concerns remain, the CBRC's efforts in seeking industry comments are praiseworthy. They said there would be a strong incentive to incorporate; high capitalization requirements would in general not be a problem for those banks intending to establish large branch networks. The capitalization requirements might, however, keep out smaller- and medium-sized banks that seek to establish boutique operations.

¶11. (SBU) In the view of the foreign banking executives, the five main concerns for foreign banks are:

(a) Limits on lending to a single borrower would be reduced and applied to a subsidiary's capital rather the consolidated capital of branch parents. This could reduce lending to large corporate clients.

(b) Some foreign banks had already qualified as QFIIs and QDIIs. There was concern that if banks were required to incorporate, they would no longer be able to meet the requirements that they manage a minimum amount of assets (USD 10 billion for QFIIs). (Comment: While the CSRC in mid-August reduced the minimum required managed assets for insurance companies and asset management companies to USD 5 billion, it left requirements unchanged for banks).

(c) Draft regulations could be interpreted to mean that once banks converted to subsidiaries, they would need a new three-year track record, with two years of profitability before being able to offer RMB-denominated services.

(d) A separately capitalized subsidiary might have a lower credit rating, and thus a higher cost of funds than its parent.

¶12. (SBU) The draft regulations also require that a controlling shareholder of a foreign bank be a commercial bank, which reflects the growing political sensitivity to rising FDI from equity and hedge funds, both inside and outside the financial sector.

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